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General Business Conditions

THE attention of business during the past month has been centered on the commodity markets and on the operation of the new Price Control Extension Act which became effective July 26. Both in pricing and decontrol, the Act necessarily gave a good deal of leeway to the administrators, and business men were concerned to know what policies and standards would be established. Most important of the decisions to be made were those of the new Price Decontrol Board, required by August 20, as to reinstatement of ceilings on farm products. A second unknown quantity was whether the Office of Price Administration would interpret liberally or severely the provisions under which manufacturers and distributors could apply for relief from price squeezes, under new formulas.

Apart from these questions, the reestablishment of ceilings after twenty-five days of free markets naturally caused difficulties. With the exceptions stated in the Act, prices of commodities under ceilings were automatically rolled back to June 30 levels, irrespective of any new conditions that had developed or of the new provisions in the Act. Immediate adjustments were required to let business go on — for example, price increases to offset stoppage of subsidies, to allow for advances in raw materials during the interim period, or to adjust prices on imported goods to higher markets abroad. In the main the most necessary changes have been made, although there are glaring exceptions, as in the hide market; a refusal by OPA to raise cattle hide prices despite sharp advances abroad and the higher cattle prices here has cut down the movement of hides drastically, curtailed leather and shoe production, and left the situation chaotic.

The Decision on Farm Products

The decision of the Price Decontrol Board to restore ceilings on livestocks, meats and oilseeds, while leaving grains and dairy products free of control, is being criticized in many quarters. For those who believe in the philosophy of control, or who would subordinate all other considerations to keeping prices down, the decontrol of dairy products and grains provided a target. Labor unions and representatives of consumers' organizations have aimed criticism at this part of the decision. On the other hand, the recontrol of meats was discouraging to those who put their faith in a free price system. All branches of the meat and livestock industries, and many consumers as well, have protested strongly against the reinstatement of controls which had discouraged production, disrupted distribution and led to widespread evasions and black markets.

In commenting on these criticisms, the principle should be laid down that in any organized society someone must have the last word, and that if society is to function people must abide by final decisions, submerge their differences, and cooperate in trying to make the decisions work. The price controls had thorough examination and debate in Congress, and a bill was passed which irrespective of its merits or demerits represented the judgment of Congress. Establishment of the Price Decontrol Board to supersede OPA in deciding when to remove controls was generally acclaimed, and the appointments to it were generally praised. The common interest requires that its decisions be accepted in good spirit and that people work together to make the best of the program adopted.

This principle should rule out criticism based on special interests or mere recalcitrance, and limit discussion to objective appraisal of the probable effects of the decision and the reasoning which governed it. Such statements as that made by the cost-of-living committee of the Congress of Industrial Organizations — that the decontrol of grains and dairy products constituted "a dismal failure to recognize the seriousness of increasing inflation of food costs," which "will add a further burden on the workers' budget" — make strange reading in light of the language employed by the

Board. Far from being insensitive to the seriousness of food price rises, the Board recontrolled meats mainly because prices were "unreasonable". It left dairy products uncontrolled because it found specifically that prices had not risen unreasonably above the June 30 ceiling plus subsidy, and for no other reason; and it will watch the situation and reconsider if necessary. As to grains, the Board found that the supply after the harvest of the current crops would be adequate, with which everyone will agree, and it pointed to the indisputable fact that prices of new crop futures had not advanced, but on the contrary had dropped in most cases below June 30 ceilings. This answers the C.I.O. statement that "runaway prices on grains . . . will leave a continuous problem into 1947."

In fact, the record-breaking wheat, corn and oats crops grown this year will be a stabilizing factor whose importance in the cost of living is hard to overestimate. An abundant supply of corn and other grains is the first requirement for an abundant output of livestock and dairy products, and the prospective supply of feeds relative to the number of animals to be fed is the largest in all our history. The price of feed is the basic cost of these products, and prices have continued easy, with quotations on Chicago corn futures down another 10 cents or so to around $1.30, during August. This is 15 cents under the old ceiling. New crop corn will be widely available in another month to six weeks, and the price of $2.00 which corn brings in the current spot market will pass into history. The corn market will act as an anchor to hold down a very considerable segment of the food cost of living. March wheat futures at $1.88 are 10½ cents under the old ceiling.

Principles Followed by the Board

The Price Decontrol Board found that livestock and meat prices had risen unreasonably above June 30 ceilings plus subsidies, and on that point its decision to recontrol them accorded with the instruction of Congress as expressed in the Act.

The Board also found — as it had to if recontrol was to conform to the law — that regulation of livestock and meats was practicable and enforceable. On this point experienced opinion, outside OPA, is entirely skeptical. At prices below those of free markets, demand inevitably will exceed supply, for demand is expanded by unnaturally low prices. If demand is not held within the limits of supply by free prices, the only other logical way to check it would be to reinstate rationing, but no one suggests that the American people would endure rationing under existing conditions. The OPA view is that a rough kind of rationing is enforced by the unavailability of meat for everyone in the quantities desired, and that the function of prices as the means to curtail demand can thus be dispensed with. But this unavailability is what leads to the evasion of ceilings, the diversion of supplies into inefficient and costly distribution channels, the waste of valuable products in black market slaughtering, the inequities — with the law-abiding being the sufferers — and the butcher shop lines. An enforcement problem is raised which heretofore has been unmanageable.

A third finding by the Board — also necessary if the terms of the law were to be observed — was that "the supply of meat has been and will continue to be short." To this statement based on the language of the Act the Board added its own words, not included in the Act, "in relation to demand at reasonable prices." This is an amendment which reads a meaning into the Act not conveyed by its own language, and it prompts serious questions. For if "reasonable prices" is interpreted as meaning prices substantially below those established by the free market (which alone can equate supply and demand), how can supply and demand ever balance "at reasonable prices?" How can decontrol ever be accomplished under such a formula? Is any price reasonable which will not balance supply and demand?

If quantitative criteria are applied to determine whether supply is short a different answer is obtained. The available supply of meat per person in the country is officially estimated to be 18 per cent above the five-year prewar average. The reason meat is short even with this great supply is that demand is swollen by the inflation of incomes and of money and credit. OPA has desired and intended to reestablish June 30 prices. Were June 30 prices reasonable, in view of this inflated buying power? Another consideration is that prices balance the markets not only by curtailing demand, but by stimulating production and increasing supply. Resources of feed and breeding stock are available to increase output of animal products, given time, so that the swollen demand can be satisfied. Were June 30 prices reasonable, from the viewpoint of encouraging production?

Secretary Anderson's View

Secretary of Agriculture Anderson, over OPA's protests, has exercised his authority to answer this last question in the negative. After OPA had prematurely indicated that ceiling prices would be rolled back essentially to June 30 levels, Mr. Anderson recommended that those prices be increased by $2.25 on cattle and $1.40 on hogs. This recommendation is binding. He called attention to the flood of underweight and unfinished livestock sent to market in anticipation of the rollback, as evidence that

higher prices were needed to make feeding profitable and encourage meat production. It may be added that among the hogs marketed an abnormal proportion of sows was included. To the extent that the feed lots were denuded and breeding stock reduced, the meat supply already has been shortened. Consumers will be the sufferers. Meanwhile distrust of OPA has been increased, and the feeling that it is insufficiently concerned with the effect of prices on production will be more widespread.

Whether the Secretary's action will preserve order in distribution and augment the supply despite the ceilings remains to be seen. If so, the credit will go to the fact that the prices set by him come closer to the prices that would be established in free markets.

Price Moves in Imports and Manufactures

Turning now to price moves in other fields, OPA has acted promptly to carry out the provisions of the Act where they are concrete and mandatory. Responding to the requirement that ceilings on imports must be raised or removed where their effect is to limit imports below our needs, it has raised ceilings on paper, coffee, shellac, and goatskins, removed the ceilings on pepper and other spices (also because they are unimportant in living costs), and is expected to take action on cocoa. It has raised ceilings both for manufacturers and distributors in many cases where new formulas in the Act require it to do so.

On the other hand, it is taking a stiff attitude toward applications for decontrol. It is formulating rigid standards, and the establishment by the Decontrol Board of the principle above discussed, that goods must be abundant not by quantitative standards but "at reasonable prices," arouses concern in the industries as well as in agriculture.

OPA seems to be taking an equally stiff position toward applications under the Barkley-Taft amendment. This amendment provided, subject to qualifications, that manufacturers' prices on any product should equal the average price received for it by typical producers in 1940, plus average increases in costs since. By all reports the burden of cost figures and other information required from petitioners under this provision will be onerous; and, what is even more important, OPA is making a strict interpretation of the qualifications. The main qualification in the law is that no such adjustment is required if prices now cover average total current cost plus a reasonable profit, unless a substantial expansion of production is practicable without reducing the output of equally needed products. OPA has much latitude under this provision. A press report says OPA will interpret the word "substantial" as meaning a 15 per cent increase in output within six months. In any case, there are many uncertainties which manufacturers will like to have cleared up as early as possible.

After this is said, however, it must still be considered true that, as was written in this Letter last month, "the industries, where they are producing some products at a loss or not producing them because they would incur a loss, have a stronger position before OPA than they had prior to June 30." The importance of the improvement is that a shortage of single products often stops other production. Unrealistic pricing has been greatly responsible for such shortages. It is imperative to break these bottlenecks.

The Interest of Consumers

Some of our readers may say at this point that our discussion has emphasized the interest of producers above that of consumers, and that the need to restrain inflationary rises of prices and living costs, maintain stability and prevent extortionate profits has not been sufficiently stressed. Actually the long-run interests of consumers are identical with those of producers. Consumers want goods; they also want employment. Producers want to do business. Both are benefitted by orderly markets, and both suffer from any conditions that create instability. The primary interest of both, however, is in the efficient functioning of the economic organization, so that it can deliver to people the maximum benefits of which it is capable at any given time.

All producers in the economy must recover their costs. Costs have been raised by wage advances. They are kept high because the output of workers per man-hour over a vast section of industry is lower than it should be; one survey, made by the magazine Mill and Factory, showed that in more than half of 1000 companies reporting, labor efficiency was lower than before the war. Unless these higher industrial costs are covered in prices, not merely on an average or overall basis but for all needed products, the industrial organization will not function at highest efficiency and the output of goods and services will not reach maximum.

Evidently the principal rise in the cost of living hereafter will be in processed and manufactured goods, for recent developments in the markets for farm products suggest that farm prices on the average may be as high as they are going. The farm group in the Bureau of Labor Statistics daily price index of basic commodities reached its peak as long ago as July 17, and now is being pulled down by the adjustment of corn to the new crop basis and by the ceilings reestablished for livestock.

Manufactured goods, however, have not fully reflected the advances in raw materials and wages and doubtless will show an upward

tendency for some time. The main responsibility for the rising cost of manufactured goods falls on the wage and efficiency factors above mentioned. The time to have been concerned about it, and to have averted it, was when the excessive wage increases were put into effect, at the expense of costly strikes. The way to stop the spiral now is to increase efficiency and so absorb the wage increases without raising unit costs, and the way to maintain stability is to withhold further excessive wage demands, not supported by gains in productivity.

The 41 Billion Peace-Time Budget

On August 3 the President made public revised estimates of government receipts and expenditures for the fiscal year ending June 30, 1947. The figures put a heavy damper on hopeful expectations that, with the end of the war now a year behind us, the drop in government expenditures would provide in 1947 a leeway both for tax relief and for debt reduction out of surplus revenues. Instead, we are faced with the prospect of having to keep a war-time tax structure to support peace-time expenditures scheduled at a rate unbelievable a few years ago. The President reiterates his recommendation "that no tax reduction be made until the inflationary situation is passed." The objective of a substantial budget surplus is set for a year later, fiscal 1948.

As the new figures work out, expenditures reach a total of $41.5 billion. With revenues ("net receipts") estimated on the basis of existing taxes at $39.6 billion, a budgetary deficit of $1.9 billion is indicated. The $14.2 billion cash balance in the Treasury on June 30, 1946, remaining from the Victory Loan, will cover this deficit and permit an estimated reduction in the gross debt of $8.4 billion to $261 billion on June 30, 1947. Because certain expenditures scheduled in the budget represent obligations incurred rather than actual cash outlays within the year, it is expected that cash redemptions of public marketable debt falling due — Treasury bills, certificates, and notes — may run several billions larger than the reduction in gross debt. Some $2.1 billion of expenditures will take the form of terminal leave bonds issued to veterans, $950 million will be paid in demand notes issued to the International Monetary Fund, and other sums will go to build up Social Security trust funds invested in special issues of government securities.

Compared with the estimate in the President's annual budget message last January, the figure for aggregate debt on June 30, 1947 has been lowered $10 billion. This change is mostly accounted for by the fact that the original budget overestimated the deficit for January-June 1946 by a wide margin.

The failure of the new estimates for fiscal 1947 to show a balance is due to the fact that expenditures have been boosted $5.5 billion. The revenue figure has been raised from $31.5 billion in the January budget to $39.6 billion. The higher figure, based on "the expectation that the high dollar volume of economic activity will continue, with a high level of taxable individual and corporate incomes and large sales of taxable commodities," would have covered the estimate of expenditures made last January, with $3.6 billion to spare.

Federal Budget Comparisons
(Millions of dollars, fiscal years ending June 30)

	1939	1946	1947 Jan. '46 Estimates	1947 Aug. '46 Estimates
Budget expenditures	$8,707	$63,714	$36,000	$41,500
Budget receipts (net)	5,165	43,038	31,500	39,600
Net deficit	3,542	20,676	4,500	1,900
Gross debt at end of year	40,440	269,422	271,000	261,000

The increase of $5.5 billion in expenditures reflects the recently authorized $2.4 billion terminal leave pay for enlisted men, enlargement of the military and naval program, pay increases, increased pensions and benefits for veterans, postponement from fiscal 1946 to 1947 of the U. S. subscription to the International Monetary Fund, and underestimates of certain items in the original projections.

How Much is 41 Billion Dollars?

How much is $41 billion? Before the war such a figure for peace-time government expenditures would have seemed utterly fantastic. With the wartime experience so close behind us — when public funds were poured out in profusion to save lives and gain the victory — our sensibilities have been dulled.

The meaning may be made clearer if we realize, as shown in the table below, that for the *single peace-time year* ending June 30 next, contemplated expenditures run to more than in the *three years* of World War I, more than in the entire *decade* of the twenties, and more than in the *five years* of liberal spending just before the outbreak of World War II. It is 26 per cent of the estimated total national income, and imposes a tax burden of around $1,000 on the average American family.

Expenditures of the Federal Government
(Fiscal years ending June 30)

Three years of U.S. participation in First World War, 1917-19	$33,190,000,000
Ten years of general prosperity, 1921-30	33,810,000,000
Five years of large spending, 1935-39	39,799,000,000
Projected total for the single peace-time year, 1947	41,500,000,000

Where the Money Goes

In the next table we show the breakdown of the scheduled $41 billion expenditures, with comparative figures for 1939 from the Annual Report of the Secretary of the Treasury. While the comparability of some of the individual classifications may be affected by changes in government accounting, the general picture is

clear. New items show up, loaded onto those created during the '30s; old items are swollen, some beyond recognition. The few decreases are restricted to activities designed in 1939 to make jobs and to support income and purchasing power. Even so, the net total for social security, aids to agriculture, and general public works aggregates $3,313 million—which would have supported the entire government establishment in any one of the years 1923-29.

Government Expenditures
(In Millions of Dollars)

	Fiscal Years ending June 30 1939	1947
War Department	$ 490	$8,060
Navy Department	673	5,150
Terminal leave of enlisted personnel	0	2,418
U. S. Maritime Commission	44	290
War Shipping Administration	0	412
Other (includes UNRRA)	0	2,178
National defense subtotal	1,206	18,508
Interest on public debt	941	5,000
Refunds	66	1,857
Veterans pensions and benefits	557	6,205
International finance	0	4,168
Aids to agriculture, including subsidies	1,228	1,174
Social security, relief and retirement	2,984	1,252
Housing, excluding defense housing	0	202
General public works program	1,000	887
Post Office Department (general fund)	40	241
General government	685	1,885
Pay increase not absorbed above (anticipated supplemental appropriations)	0	160
Total expenditures	$8,707	$41,539

Total "National defense" comes to 15 times the cost in 1939 when the war clouds hung so heavily over Europe; without the terminal leave pay it would still run 13 times. With the conditions in the world today, Americans recognize the need for maintaining a high degree of military preparedness; but the President must have had defense expenditures as well as other items in mind when he said:

> During the years of fighting, financial considerations had to be subordinated to victory with the least sacrifice of lives. This urgency is no longer present. Today government expenditures can and must be scrutinized minutely to obtain the maximum economy. The present inflationary situation makes it imperative that expenditures be cut to the minimum compatible with the responsibilities of Government.

The $6,205 million for veterans' pensions and benefits is 11 times the 1939 figure. While no place for penny-pinching, fiscal prudence should not be overlooked here. General Bradley, Administrator of Veterans Affairs, has publicly called attention to serious abuses of benefit privileges—able-bodied men who reject employment opportunities in order to draw $20 a week for 52 weeks, men drawing large salaries who seek to qualify for government allowances on the ground that they are training for still bigger jobs, and employers who take advantage of job training allowances to get cheap labor. With over 12 million men and women now or formerly in the armed services, veterans themselves must bear a substantial share of the national tax burden and hence have a vital interest in holding down extravagant or unwarranted benefits.

The $5,000 million for interest on the public debt, another heritage of the war, is reducible only by the gradual process of debt retirement. With interest rates already at unprecedently low levels, no appreciable reduction of interest costs is possible except as other expenditures are brought down sufficiently to produce overall budgetary surpluses.

The $4,168 million for international finance represents the heavy expense we are incurring to help put other nations on their feet economically. The greater part of it goes for the British loan, the Export-Import Bank, and the new International Bank and Monetary Fund. With these financial organizations in active operation, and private capital ready to participate in sound foreign credits, we should be able to arrest further commitments of government funds for these purposes. As Undersecretary of State William L. Clayton pointed out in discussing the State Department's decision not to ask further funds for UNRRA, "The United States is not a limitless reservoir of wealth and goods. We have some serious problems of our own . . . We must keep a careful watch over our own resources and our own liabilities." UNRRA, while conceived as an agency to which all of the United Nations would contribute, has received 96 per cent of its funds from the United States, United Kingdom, and Canada, with the United States contributing over 71 per cent.

Expenditures for "general government" (legislative, executive, judicial, and general departments and offices), up to 2¾ times the 1939 rate, provide an index to the swelling cost of maintaining the regular government departments and services. The 1947 budget for all expenditures other than "national defense" totals over $23 billion, as peace-time costs of government have been mounting steadily under cover of contracting war expenditures. Old-line and postwar agencies have been adding to their payrolls large numbers of civilian employes released by the War and Navy Departments. In a report issued August 17, Senator Byrd, Chairman of the Joint Committee on Reduction of Nonessential Federal Expenditures, stated:

> This offsetting of reductions by taking on additional employees results in a net reduction of only 901,224 employees since August, 1945, when it was at an all-time high peak of 3,649,769.
>
> In August of 1945 the federal employees were in high gear in their war production activities, whereas, though we have slowed down to an almost natural peace-time pace, the vast majority of office workers still remain on the payroll.

The conclusion that jobs have been manufactured in order that they may be retained is inescapable.

Efforts to Reduce Costs

President Truman has expressed deep concern over the trend of government expenditures and has declared it the intention of the executive branch to "use all the powers available . . . for reducing expenditures which are not directly determined by legislation and which can be postponed or reduced without serious harm to national security and welfare." In a communication to the heads of all federal departments requesting them to pare their expenditures, he said:

> **Our present fiscal situation is a most serious one. We are faced with a continued substantial budget deficit in the present fiscal year. Even those federal expenditures which are most necessary have the effect of increasing inflationary pressures in the total national economy. We must do everything within our power to reduce inflationary pressures. One of the most effective means of doing this is to reduce federal expenditures.**

In furthering this program, the President ordered cuts in certain projected increases in military and naval expenditures, and asked the Administrator of Veterans Affairs "to review and tighten certain standards (for veterans' pensions and benefits) in order to protect both the rights of deserving veterans and the national pocketbook." He recommended a postponement of public works and of government purchases of automobiles and some other scarce items. On August 5 the Director of War Mobilization and Reconversion ordered a 56-day moratorium on contract awards for public works.

The adoption by Congress of a reorganization plan, improving the coordination between the work of the appropriations and revenue committees, should lead to better budgetary procedure. Likewise, the recent legislation making the accounts of numerous government corporations and agencies — which over the years have been recipients of billions in federal grants and advances — subject to audit by the General Accounting Office should result in tighter fiscal control.

All this, of course, moves in the right direction. Anything that can be done to reduce expenditures without curtailing really essential government activities is welcome, and even minor economies are not to be disparaged. One of the great difficulties in controlling the spending program has been the development of the psychology which belittles small economies, which in the aggregate can amount to very substantial sums. Moreover, the mere cutting down of proposed increases, and deferring of postponable expenditures, while desirable, are not the answer to the problem. What is required is something that ploughs much deeper and involves the whole philosophy of the relation of people to the government. People must stop running to Washington for money, and looking to the Federal Treasury as a source of support.

This is all much easier to say than to get accomplished. Expense reduction affects too many special interests, jeopardizes too many votes. It is easy to spend more, to add new activities and agencies, to enlarge the budgets and staffs of established bureaus. Every department head can always find projects deemed worthy if the money for carrying them through is available. Once expanded, all work tends to enter into the class of "essential" and still new projects develop.

Conflict of Objectives

The basic problem that is raised is the conflict between the Administration's forcefully expressed desire for economy and the ideas that have been prevalent in Washington as to the Government's responsibility for managing the economic system and for becoming the benevolent guardian of the individual citizens. Though there is talk of the danger of inflation and the need for economy, too much of the economic thinking and policies of the depressed '30s lingers with us. It was apparent in the President's budget message to Congress last January which, despite the persisting deficit, nevertheless recommended a many point program of government aid for assuring jobs, creating purchasing power, expanding social security, and furthering other social welfare projects, the ultimate cost of which he did not even attempt to estimate.

So long as we adhere to this philosophy of "big government" we are bound to have big spending. To accomplish the economy that is essential to bring the scale of government spending, and hence of taxation, down to a level supportable under ordinary peace-time conditions, calls for a radical change in this philosophy.

With full employment and with national income at peak, now is the time when we ought to be reducing government expenditures, achieving a surplus of revenues for tax reduction, and retiring the public debt. It is a dangerous situation when the budget cannot be balanced even with full employment and a tax structure still embracing most of the war-time levies at or near maximum rates.

Planning for "Maximum" Employment

With the appointment by President Truman late in July of the three-man Council of Economic Advisers authorized by the Employment Act of 1946 — legislation originally known as the "Full Employment" bill — the United States is embarked upon a new experiment in governmental planning. The objective of the

Act is to maintain high level production and employment, and avoid extremes of inflation and deflation. Members of the Council, charged with responsibility for study of current conditions and trends and for advising the President and the country on over-all economic policies, are: Edwin G. Nourse, chairman, formerly vice president of the Brookings Institution, and an economist of high standing, well-known for his writings, especially in the field of agricultural economics; John D. Clark, dean of the College of Business Administration of the University of Nebraska; and Leon Keyserling, general counsel for the National Housing Agency, Washington, D. C.

The Act, as adopted, represents a very much "watered down" version of the original "Full Employment" bill introduced into Congress in January 1945 by Senator Murray of Montana. That bill propounded two basic principles: (1) that every individual has a right to a job and that the Government has the obligation to assure adequate job opportunities, and (2) that whenever the total of public and private spending falls below the level necessary to maintain "full employment" the Government should step in with increased spending to make up the difference. These ideas encountered strong opposition by the conservative elements in Congress, and by the time the bill was passed it had been stripped of its more controversial features.

As the law now stands, the section of the original bill referring to the "right to work" and obligation of the Government to assure jobs has been dropped, as has been any direct reference to government "pump-priming" or "compensatory spending" to maintain employment. The term "full employment" has been eliminated in favor of "maximum employment". The Act defines objectives in general terms, and does not attempt to prescribe any specific program of economic action. The declaration of policy reads as follows:

> The Congress hereby declares that it is the continuing policy and responsibility of the Federal Government to use all practicable means consistent with its needs and obligations and other essential considerations of national policy, with the assistance and cooperation of industry, agriculture, labor, and State and local governments, to coordinate and utilize all its plans, functions, and resources for the purpose of creating and maintaining, in a manner calculated to foster and promote free competitive enterprise and the general welfare, conditions under which there will be afforded useful employment opportunities, including self-employment, for those able, willing, and seeking to work, and to promote maximum employment, production, and purchasing power.

The President is to transmit to Congress shortly after the opening of each regular session a report reviewing the economic condition of the country, and presenting his views as to the measures required to achieve the purposes expressed in the Act. Instead, however, of the elaborate provisions of the original bill calling for a "National Production and Employment Budget" and making mandatory a program of government spending calculated to maintain "full employment" in the event of an estimated deficiency in public and private spending, the Act states simply that the President is to present a program "for carrying out the policy declared in section 2 (quoted above), together with such recommendations as he may deem necessary or desirable."

It is to aid the President in the preparation of this report and in the formulation of policy that the Council of Economic Advisers has been set up.

Weakness of Government Spending Thesis

That Congress in adopting the Employment Act refused to accept the principle of government spending as the cure-all for economic depression has been, of course, a disappointment to the many believers in that doctrine. There is no doubt that the theory has wide appeal, both because of its simplicity, and because of the demonstration during the war of what heavy government spending can do in putting people to work and promoting a high level of production and purchasing power.

This faith in government spending has received effective intellectual support from the teachings of the British economist, the late Lord Keynes, which attempted to explain the incomplete recovery of the '30s as due to inherent deficiencies in the private enterprise system that—barring the stimulus of government spending — doom it to more or less permanent semi-stagnation. Thanks very largely to this Keynesian teaching and the wartime experience, there has developed an influential body of opinion that governments have found in compensatory spending the talisman to control booms and depressions.

Dr. Arthur F. Burns, director of research of the National Bureau of Economic Research, a non-partisan organization of highest scientific standing, has challenged as unproved the Keynesian thesis of stagnation and necessity for government spending in a scholarly and significant analysis in the annual report* of the Bureau made public last June. Pointing out that this Keynesian doctrine is based largely on theoretical reasoning, Dr. Burns recalls some of the similarly evolved theories of earlier economists not borne out by later experience, and warns against attaching too much certainty to new doctrines as yet unverified by adequate evidence.

"The great and obvious virtue of the remedies proposed by the Keynesians," declares Dr.

*Economic Research and the Keynesian Thinking of Our Times; by Arthur F. Burns; Twenty-sixth Annual Report, National Bureau of Economic Research, Inc., 1819 Broadway, New York 23, N. Y.

Burns, "is that they seek to relieve mass unemployment; their weakness is that they lean heavily upon speculative analysis of uncertain value." Again, "the Keynesians lack a clear analytic foundation for judging how a given fiscal policy will affect the size of the national income or the volume of employment."

In further analysis of Keynesian theory, Dr. Burns presents examples of where this theory "collides with the facts of experience."

Need for More Factual Knowledge

The truth is — and this is the real burden of Dr. Burns' discussion —that we need more facts about economic behavior. While there are many theories of the business cycle, we still lack, as Dr. Burns points out, precise and tested knowledge of what business cycles in actual life have been like. The National Bureau of Economic Research has been engaged for years in developing such studies, and some idea of the monumental character of the work may be gained from the fact that, whereas the first study in the projected series — Professor Wesley Mitchell's "Business Cycles: The Problem and Its Setting" — was published in 1927, the second study in the series — "Measuring Business Cycles," by Dr. Burns and Professor Mitchell, and dealing mainly with methodology — has been published only within the past month.

The very scope of such scientific investigations should warn us against hasty assumptions that the problem of the business cycle is solved and that perpetual prosperity is within our grasp. In the present state of our knowledge we would do well to adopt prudence as the watchword in our economic planning, and not go off the deep end for any new program until we are pretty sure we know what we are doing.

There is reason to be particularly sceptical of schemes based on the theory that government can anticipate the economic tides and regulate their movement by turning public spending on and off, at just the right times and in just the right amounts. The widely-heralded Washington prophecies of unemployment and deflation following V-J day are recent glaring examples of the fallibility of government forecasting. Experience, moreover, has demonstrated that government spending is much easier to start than to stop. No one doubts that the Government can bring about "full employment" if it only spends enough, but at what ultimate cost in the way of inflation, debt, and postponed readjustments, leading to a later day of reckoning, is another question.

In this connection, it is appropriate to refer to the thoughtful address by Professor John Jewkes of the University of Manchester, England, before the National Bureau of Economic Research in New York last June on "Second Thoughts on the British White Paper on Employment Policy." Professor Jewkes is one of Britain's outstanding economists, and assisted in the preparation of this White Paper, published in May 1944, committing the British Government to acceptance of the Keynesian full employment doctrine. His address is notable for its frank discussion, by one who can hardly be classed as "reactionary," of the formidable problems of putting full employment theory into practice. While space here available does not permit extended quotation, the following will indicate the nature of his "second thoughts" which are all the more impressive by reason of his connection with the drafting of the plan:

> I still feel that the White Paper on Employment Policy is one of the most important declarations on economic matters ever made by a British Government. But I must confess the lustre of that document and of its publication day have become somewhat dimmed . . .
> . . . having now foresaken an office for a study, the permanent marriage of theory and practice in employment policy seems to me to present more difficulties than it did at one time and certainly success calls for further research into many dim and perplexing corners of the economic and administrative mechanism.

No Simple Problem

In other words, this is no simple problem that we have before us. We cannot leap at the conclusion that government spending is the answer. From a political point of view, of course, the reasons why discussions of economic instability have focussed on what should be done in an actual depression is, that is the time when people run to Washington and tell their representatives their troubles and seek to enlist their support. When the other kind of instability is happening — that is, excesses such as inflation, overexpansion, soaring farm prices, piling up of inventories, — then people not only keep away from Washington but resent interference.

One thing, however, that clearly emerges from all these discussions is that the root of depressions is to be found in previous periods of inflation and overdevelopment. In other words, the depression is, in a measure, the morning headache after the night's debauch. Something of this philosophy appears in the no doubt carefully considered statement which Dr. Nourse, a long student of these matters, made shortly after taking office as chairman of the new economic Council: "The immediate task in maintaining the economic health of the nation is to hold inflationary forces down so that we do not get into a runaway boom."

Germany; The First Year Since Potsdam

More than a year has elapsed since the policies to be followed in the occupation of Germany were decided upon at the Potsdam conference, and although the record includes much

of faithful work and progress the continuing difficulties and problems command more attention. Secretary of State Byrnes, in a report to the nation in July, had few good words to say about the situation. "The four power control of Germany on a zonal basis is not working well," he said. "The movement of people, trade, ideas among the zones is more narrowly restricted than among most independent countries. In consequence, none of the zones is self-supporting. Our zone costs our taxpayers over $200 million a year, and despite the heavy financial burden being borne by ourselves and other occupying powers, Germany is threatened with inflation and economic paralysis."

To relieve economic stagnation and to prevent suffering, Mr. Byrnes announced that the United States was prepared to administer our zone in conjunction with any one or more of the other zones, — an invitation which the British have since accepted in principle. "We will either secure economic cooperation between the zones," Mr. Byrnes emphasized, "or we will place the responsibility for the violation of the Potsdam agreement."

The Potsdam Program

The decisions made at Potsdam, in substance, were the following: (1) that Germany should be demilitarized; (2) that German productive capacity should be reduced to a level sufficient to support a standard of living no higher than that of the neighboring countries; (3) that reparations should be met by removal of industrial equipment and from German external assets; and (4) that Germany should be administered as a single economic unit. Common economic policies were to be worked out and central administrative departments handling finance, foreign trade, transport, and communications organized under direction of the Allied Control Council, a body meeting in Berlin.

A few months after Potsdam, a plan was worked out for the allotment of German reparations and last March the Allied Control Council adopted the so-called "Level-of-German-Industry Agreement" which established the allowable postwar capacity of German industries. This agreement disarmed Germany industrially. From the wartime figure of 25 million tons (Greater Germany), steel capacity will be slashed to 7.5 million tons, with allowable production set at 5.8 million tons in any one year. In addition, 21 other major industry groups, such as basic chemicals, machine tools, dyestuffs, heavy engineering products, and non-ferrous metals, will be restricted. These are primarily the industries from which machinery and equipment will be taken for reparations. Allowable capacity is slated to run from 80 per cent (pharmaceuticals) of prewar down to 11 per cent (machine tools).

Germany will thus become a country producing largely consumers' goods. The April report of our Military Government, from which much of the above is taken, points out:

> By 1949, Germany's overall industrial capacity is expected to be reduced to approximately 50 to 55 per cent of the prewar 1938 level. As compared with the average standard of living before the war (1930-38), it is estimated that the planned reduction in Germany's resources will bring a 30 per cent cut in the standard of living, or down to about the European average.

Creating Order Out of Chaos

To carry out the Potsdam decisions, and at the same time to create order out of the chaos existing in Germany at the end of the war, has been a task of almost incomprehensible difficulty. Food had to be supplied, the most essential industrial plant repaired, and the smashed transportation and public utility services restored, — all while de-Nazification and de-industrialization went on. The occupying powers were faced also with the problem of mass migration: over 10 million Germans from the East had to be resettled in the remainder of Germany, while several million displaced persons had to be returned home. A completely new administrative system had to be built from the ground up.

Within limits, the military governments have accomplished much. Some of the problems are on the way to solution. Railways and public utilities have begun to operate although on a meager basis, and a large part of the industrial plant surviving the war has been put to use.

But in doing all this, the four governments have relied mostly on the resources of their respective zones. In other words, one of the basic principles of the Potsdam Agreement — that Germany be treated as a single economic unit — has not been carried out. The central economic agencies have not been established. No common policies regarding trade, finances, and labor regulations exist. Rather, the four powers have adopted in their respective zones the political organization and business methods growing out of their own past experience. Where this has led has been described by Professor Edward S. Mason of Harvard University, recently of the Office of Stragetic Services, in the July issue of "Foreign Affairs":

> . . . economic and political activities are proceeding in the different zones in very different directions and at a very unequal pace. In the Russian zone, there has been extensive nationalization of such industry as remains; the authorities have insisted on a united front in political parties and trade unions; they have imposed systematic and comprehensive land reforms. In the British zone, the coal mines have been nationalized, revolutionary movements have been discouraged and a beginning has been made at building up the Social-Democratic party. The Americans, by all accounts, have pursued a more drastic policy of de-Nazification than is favored elsewhere; they have

carried through a program of local elections; and their economic policy seems to have been essentially negative.

Today there are in Germany, to quote again from our Military Government report, "four widely different systems of economic planning and administration and consequently four unrelated economic programs." The longer this situation persists, the more difficult it will be to follow common economic policies and to establish a central economic administration. The report warns that there is —

grave danger of the imprints of the zonal governments becoming too pronounced . . . because they will leave distinct areas bearing the brand of the political and economic philosophies of the respective occupying powers. The latter has tremendous international implications, as well as frustrating domestic possibilities.

Disintegration of Price and Money Systems

Although the occupation powers favor increased trade among the zones, and have, in fact, been promoting it in some degree, the lack of common economic and financial policies has been obstructing it. There is no legal exchange rate for the mark at present. The rate of ten marks to the dollar is merely a military conversion rate for calculating the pay of occupation troops. With circulation more than five times as large as before the war, still more marks probably being printed by the Russians, and the regional governments operating at deficits, people as a rule prefer cigarettes and watches to paper money as standards of value. Long overdue currency reform cannot be carried out under present political conditions.

In the three Western zones, the banks have been allowed to reopen. A plan is now under consideration for the reorganization of the Reichsbank branches into provincial central banks which would operate much like our own Federal Reserve Banks. But in the Russian zone the banks, including the Reichsbank, were closed and their old deposits blocked. Banking functions there are carried out by new state banks, modeled after those in Russia.

Under such financial conditions interzonal trade has been reduced to barter. A German firm in the American zone is not interested in being paid in marks for goods shipped to the Russian or British zones; it wants goods in return. This has led to an extremely complicated and cumbersome drawing up of lists of goods that can be bartered. It often takes months to carry out a simple transaction.

The difficulties of transportation and communication between zones have been on a par with the financial difficulties, though they have been somewhat lightened by various measures and agreements as time has passed. Efficient utilization of natural resources, productive capacity, and labor is hampered by the crippling of internal trade. Doubtless many Germans contrast this deteriorating situation with the war-based prosperity under the Nazis, which is hardly helpful to the program of re-educating the German people to democratic institutions and to a peaceful life.

The American occupation authorities have been particularly conscious of the vicious effect of the division of Germany on industrial production. The American zone is much dependent on other parts of Germany for such industrial raw materials as coal, raw steel, synthetic rubber, and basic chemicals, and also for industrial machinery and spare parts. In reading through the excellent and thorough reports prepared by the United States Military Government, one is struck by the fact that much of the industrial activity has been possible only because there were reserves of materials and parts on hand at the time of occupation. These stocks are being depleted and a more efficient and larger-volume exchange of goods with other zones is imperative.

The American occupation authorities are also concerned lest economic stagnation lead to dissatisfaction which would nullify their job of de-Nazification, which has been more thorough than in the other zones and of which they are justly proud. Through elections and through encouraging German participation in the administration of the zone the Americans have been quite successful in overcoming the political apathy of the German people.

Economic Fusion of U. S. and British Zones

The most significant move toward common economic policies is one which Secretary Byrnes said frankly was to be taken as a "last resort," and only because united action by all four powers could not be had. This is the British-American agreement upon an economic "merger" of their two zones. Even though a half-measure, its benefits will be obvious. Full arrangements will take time to work out, but already the movement of people and goods between the two zones has been freed from interruption at the border.

The British zone, which includes the Ruhr area and is thus the main source of coal and steel, is economically the most important of the four zones. Before the war, it contributed more than any other zone to the country's internal and external trade. But it had to draw in turn on other parts of Germany and other countries for food, raw materials, and even labor. The collapse and disruption of internal trade caught the British zone in the vicious circle, which the London Economist described as "no coal — no food — no work — no coal."

By permitting an increased exchange of goods and a better division of labor, the economic fusion of the British and American zones is expected to lift the output of goods, which continues to be far below the quotas set

in the Level-of-Industry Agreement. The rate of industrial production in the U.S. zone was reported at about 30 per cent of capacity in July and in the British zone around 40 per cent.

Germany Must Export to Live

It must be recognized that however desirable this fusion, it will not solve the problem of making Germany self-supporting. Large quantities of raw materials will have to be imported to keep even the non-war industries going. Germany will also need food, for she cannot feed herself with over one-seventh of her territory, mostly agricultural surplus producing land in the East, lost. To pay for imports of raw materials and food Germany will have to produce considerable surpluses of goods for export. Until her production is raised to the point where a surplus for export exists, her necessary imports will be at the expense of her conquerors.

This need to trade with the world is bound to challenge in time the feasibility of the Potsdam Agreement and the subsequent "limitation of industry" plans. But General W. H. Draper, head of the Economics Division of the Military Government, believes that revision of the Level-of-Industry Agreement is not an immediate issue, because at the present rate it would take Germany from three to five years to reach even the reduced levels of output permitted under the Agreement.

Increased German production, to the point where Germany may both sell and buy abroad, is also one of the keys to the economic recovery of Europe. The largest manufacturing and trading country on the Continent, Germany was the central cog in a vast intra-European trade vital to the prosperity of all European countries. She provided the small countries with the advantages of a large market and made possible the exchange of specialized products.

This trade has been at a standstill now for more than one year. Except for some coal and electric power, and some goods manufactured in German factories for Russia, little has been moving out of the country. Yet neighboring countries are badly in need of German fertilizers; their industries are in equally great need of German chemicals and spare parts for their German-made machinery. Unless German industrial production is increased and some of the intra-European trade restored, recovery in the countries neighboring Germany is bound to be handicapped. The transfer of German machinery abroad will help only a little, for, as the eighth report of the Colmer Committee on Postwar Economic Policy and Planning has pointed out, the shifting of machinery is not sufficient in itself to create the conditions necessary to industrial production without the combination of skilled workers, management, organization, plant location, and resources.

Patience Required

To reconcile the program for rehabilitation with the program of de-militarization and de-industrialization will call for economic statesmanship of a high order. History has seen few examples of political and economic collapse as great as that in Germany as a result of the war. The task of restoring economic and political life has only begun. If it is to be accomplished, and if Germany is to assume her place without being a threat to her neighbors, the patient work of many years will be required. Not only must we stay with the job, but we must see to it that the right people are selected to carry it out. One of our greatest difficulties has been to recruit and keep a staff of the very high ability and experience required for this exacting task. So far we have been fortunate, but we do well to recognize that this will be a critical problem, for we must have able representatives in Germany for some years to come.

There is no single cure for the problem of Germany; progress may consist of a series of steps such as the "merger" of the American and British zones, each step going as far as is practicable at the moment. Another example is the new arrangements, affecting these zones, to let American business men into Germany and enlist private enterprise in the revival of trade.

Despite the differences in their philosophies and aims, the powers have been able to compromise on many individual problems, in the operation of the thirty-three four-power committees which function under the Control Council. The situation would be worse than it is but for helpful agreements, unfortunately minor in scope, reached by these committees. But unless agreement at higher levels can produce a greater economic unity, merely to keep the German people alive will continue to burden the occupying powers and perpetuate the condition which requires us, as commentators have said, to pay reparations to Germany instead of the other way around.

Moreover, Germany is in a sense the crucible where the capacity of the great powers to work together is being tried out. It is little exaggeration to say that on the success of this venture rests the peace of the world.

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